NO. 2575

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

GEO. M. HEALY, as Trustee in Bankruptcy of the Estate and Effects of H. J. Martin,
Plaintiff-Appellant.

v.

W. H. WEHRUNG,
Defendant-Appellee.

BRIEF OF APPELLEE.

Upon Appeal from the District Court of the United States for the District of Oregon.

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Defendant-Appellee.

BRIEF OF APPELLEE.

STATEMENT OF THE CASE.

Appellant commenced this suit in the United States District Court for the District of Oregon, to recover a certain sum of money from the appellee, alleged to have been transferred or paid to the appellee by H. J. Martin, a bankrupt, while insolvent,

and within four months immediately preceding the filing of his petition in bankruptcy.

The case was put at issue by the pleadings and tried before the Hon. Robert S. Bean, District Judge presiding in said court; testimony was adduced before the court and the court, being fully advised in the premises, on the 11th day of June, 1914, ordered, adjudged and decreed that the bill of complaint be dismissed and that said defendant (appellee) do have and recover of and from said plaintiff (appellant) his costs and disbursements.

ARGUMENT.

It is admitted in the pleadings and proof in this case that on the 25th day of March, 1913, H. J. Martin filed his petition to be adjudged a voluntary bankrupt in accordance with the Acts of Congress known as "The Bankruptcy Act of 1898," and Amendments thereto, and that on the same day, Martin was duly adjudged a bankrupt.

It is also admitted in the pleadings and proof that on the 4th day of March, 1913, and within four months of the filing of said petition, said H. J. Martin paid to the appellee herein the sum of $1473.20 to be applied and the same was applied upon an indebtedness of said bankrupt due to appellee, said indebtedness being evidenced by two certain promissory notes, designated in the Transcript of Record as "Trustee Exhibit 1" and "Trustee Exhibit 2," set forth on pages 55, 56 and 57 of the Record.

As this is a suit to set aside a preference and recover the value thereof, it is first necessary to determine the elements of a preference, and then to determine upon what grounds a preference may be avoided.

As applied to the facts in the case at bar, a preference consists in a person,

First: While insolvent;

Second: Within four months immediately preceding the filing of his petition to be adjudged a bankrupt;

Third: Making a transfer of his property;

Fourth: The effect of which will be to enable one creditor to obtain a greater percentage of his debt than any other creditor of the same class.

It is necessary that these four essential elements be established by competent evidence before the court can say as a matter of fact that a preference was given, and the burden of establishing the fact that a preference was given rests upon the appellant who is seeking to avoid it.

The second and third elements having been admitted by the pleadings, it is still necessary that the first and fourth element be established by competent evidence.

The appellant must not only establish that a preference was given, but he must go further, in order to avoid that preference, and show that the person receiving the preference had reasonable

cause to believe that the transfer or payment would effect a preference.

The payment of the money by Martin to appellee being admittedly within the four months' period, there is really only two questions of fact to be determined by the Court.

First: Was Martin insolvent at the time he paid the money to appellee?

Second: Did appellee at the time have reasonable cause to believe that said payment would effect a preference?

MARTIN'S ASSETS.

Under Section 1 (15) of the governing bankrupt act, a person shall be deemed insolvent whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, with intent to defraud, hinder or delay his creditors, shall not, at a fair valuation, be sufficient in amount to pay his debts.

Where property is transferred in payment of a just debt, the mere fact that it may involve a preference in bankruptcy, should bankruptcy proceedings be instituted, does not exclude it from consideration in determining the debtor's solvency.

> In re Doscher (D. C., N. Y.) 9 Am. B. R. 547, 120 Fed 408, at page 414.

In the case at bar, then, the value of the property transferred in payment of the debt ought to be

added to the value of all other property of the debtor to determine the fair valuation of the debtor's property.

As the property transferred by Martin to appellee was a sum of money amounting to $5875.00, we may safely say that the fair valuation of the property transferred was $5875.00.

At the time this money was paid, Martin was conducting, and was the owner of, a drug store and post-card business in Portland, Oregon; and owned a stock of goods and fixtures in the drug store and a stock of post-cards and fixtures in the post-card business, and certain outstanding accounts due or unpaid for stock sold in the regular course of business.

Martin also at said time owned his home in Portland, Oregon, worth probably $10,000.00, so far as the evidence in the Transcript of Record discloses. (Record, page 84.)

The record is silent as to whether or not Martin owned any other assets at that time, and although Martin was a witness on behalf of the Trustee (see Record, pages 61 to 65), no attempt was made to show that he owned no other assets. He was not even asked the question; and clearly the Court cannot assume that he had no other assets.

See, on this point, Tumlin v. Bryan (CCA 5th Cir.) 165 Fed. 166, at page 167, where the court, speaking through Shelby, Circuit Judge, said:

> "The case turns on the contention of the defendant that there is no suffi-

> cient evidence to sustain the decree showing that the bankrupts were insolvent at the time the payments were made. * * * "

The Court then states the rule to determine insolvency as defined in Section 1 (15) of the governing bankrupt act, and continues:

> "The complainant, as a witness for himself, in answer to a question which assumed that he had gone through the books and familiarized himself with the condition of affairs of A. B. Tumlin Company, testified that 'They were insolvent in my opinion;' the answer referring to their condition on July 1, 1906, about the time the payments in question were made. *He was not asked what property the firm owned,* nor its value, nor the amount of the firm's debts. * * * *It is not shown what property was owned by the firm in July, 1906, at the date of the payments,* nor is the value of the property then owned by it proved."

It appears also that the Trustee was a witness in his own behalf, but he was not even asked what property Martin owned at the time appellee was paid the money, neither does it appear that the Trustee made any investigation to ascertain whether Martin owned any other property at that time.

Martin may have had ample property at the time he paid appellee this money, and sold and disposed of it subsequently and prior to the filing of his involuntary petition; in which event, it would

never have passed into the possession of the Trustee, and unless the Trustee presented some evidence tending to show that no transfer of property was made during that period of time, he could not claim that the property which did come into his possession subsequently, was the only property Martin had a month or so previously.

As was said by the learned referee, whose language was adopted by the court in the case of In re Chappell (D. C., Va.) 7 Am. B. R. 608, 113 Fed. 545, at page 547:

> "The company might have been solvent on October 17th, and hopelessly insolvent two weeks later. The bankrupt, Jno. A. Chappell, might have been insolvent on the 8th of November, 1900, the day on which he filed his petition and was adjudged a bankrupt, and yet solvent during the period of time from July 13 to November 1, 1900, covering the several payments in the trustee's petition mentioned."

There is no evidence to show what the different items of property which made up the drug stock or the post-card buisness or the fixtures consisted of on March 4, 1913, the date Martin paid appellee—and the only evidence which in any manner refers to that property relates to the time when it was in the possession of the Trustee.

The Trustee took possession of the goods and made an inventory, just what date does not appear, but it nowhere appears in the Record that the prop-

erty as inventoried by the Trustee was all the property Martin had on March 4, 1913, in fact, the record discloses the contrary, for it does appear that between March 4, 1913, and March 25, 1913, the date Martin was adjudged a voluntary bankrupt, he was operating and carrying on both his drug business and post-card business, thus naturally leading us to conclude that he was selling various and divers articles of his stock in trade.

VALUE OF ASSETS.

In order to determine whether or not Martin was insolvent on March 4, 1913, the fair valuation of the assets must be ascertained.

As stated above, the fair valuation of the money paid to appellee was $5875.00 and the valuation of Martin's home was $10,000.00.

There is no attempt to determine the valuation of the drug stock and fixtures or the post-card stock and fixtures or the outstanding accounts due or unpaid to Martin on March 4, 1913.

The Trustee has, however, adopted an ingenuous method to determine the value of this stock—and the same method to determine Martin's insolvency on March 4, 1913.

It is this: The bankrupt estate, which came into his hands as Trustee, was inventoried, appraised and sold by the Trustee, and after paying some preferred claims and a 5% dividend there remained cash on hand in the sum of $2882.00 only. The Trustee adopts the amount he sold the estate

for as the valuation thereof, a month before he took possession of it; and then, in effect, says that the claims proved in bankruptcy amounted to $49,-534.00, and that the total indebtedness, as shown by the schedule in bankruptcy, amounted to $69,742.00. Hence, because of the fact that the amount of money realized on the bankrupt estate in liquidation in bankruptcy was insufficient to pay the claims proved, the bankrupt was insolvent on March 4, 1913, the time he paid appellee the money. There is no other evidence of the value of the drug stock, the post-card stock, the fixtures or the outstanding accounts at any time.

The inventory and appraisement is not a part of the Record, nor is the schedules filed by Martin with his petition, and hence the contents of those instruments cannot aid us in arriving at any conclusion.

Clearly the contents of the inventory and appraisement, if in this record, would have no bearing whatever in determining the value of the assets on March 4, 1913, nor would the contents of the schedules of assets aid us any, for the valuation, if any, which might be shown by the schedules, would not be considered in determining a fair valuation at an earlier date.

In the case of Tumlin v. Bryan, 165 Fed. at page 167, the Court said:

> "The schedules filed by the bankrupt firm December 27, 1906, are relied on as showing insolvency of the firm

> in July, 1906. If from these schedules and the dates of accounts listed it be conceded that the firm's indebtedness in July, 1906, may be ascertained, and that other schedules show the property owned by the firm at the time of the bankruptcy, this is not sufficient. It is not shown what property was owned by the firm in July, 1906, at the date of the payments, *nor is the value of the property then owned by it proved.*"

The only evidence in any manner relating to the value of the store stocks, accounts and fixtures at any date prior to the adjudication was given by appellee and disclosed in Defense Exhibit B shown on page 71 of the Record, appellee's testimony as to value being based upon that Exhibit, and given in his testimony relative thereto.

Defense Exhibit B is a "Joint Statement" made by Martin on February 1, 1913, and handed to appellee by Martin close to that date (Trans., p. 69). Counsel for appellant, in his brief, page 23, says this statement was false, but there is not one word of testimony in the entire Transcript of Record, directed towards even attempting to establish its falsity.

The statement upon its face purports to show Martin's assets and liabilities, February 1, 1913.

The value of the assets are based on the "inventory price—the original cost price." (Trans., p. 73.)

None of Martin's assets, except the drug store and the post-card inventory of goods and accounts,

was included in this statement—no real property whatever. (Trans., p. 70.)

All valueless stock—that is, stock so depreciated in value as to become practically unsalable—had been set aside and allowance made for that in this statement. (Trans., p. 73.)

The inventory or original cost price is a fair valuation (Trans., p. 74) to put on the stock of goods.

The fixtures are worth cost price (Trans., pp. 75 and 76).

The outstanding accounts were worth 90 cents on the dollar (Trans., p. 79).

In the light of these facts the value of the stock in trade may in a measure be ascertained.

The value of that portion of the assets shown in the statement is		$57,354.22
From this should be deducted 10% of the outstanding accounts, or the sum of		997.13
Leaving as the value of the stock in trade		$56,357.09
Add to this the value of the real estate:		
Washington County land	$ 5,875.00	
Martin's home	10,000.00	
	$15,875.00	15,875.00
Total value of assets disclosed in record		$72,232.09

LIABILITIES.

The amount of the liabilities of Martin existing on March 4, 1913, is not ascertainable with any degree of definiteness from this record.

The Trustee, on pages 22 and 23 of the Transcript, testified that the amount of the claims proven in bankruptcy was $49,534.00. These claims were not introduced in evidence, and we are unable to ascertain from any testimony in the record when the indebtedness, evidenced by the claims, originated, or what part of it, if any, existed on March 4, 1913, or what part of it, if any, originated subsequent to March 4, 1913. These claims were in the possession of the Trustee or the Referee and could have been introduced. They were available in the hands of the Trustee. We can only presume they were not introduced as evidence for the reason that the contents would disclose facts adverse to the contention of the Trustee.

The Trustee also testified (Trans., p. 23) that the indebtedness of the bankrupt, as shown by the schedules in bankruptcy, was $69,742.00, but the schedules were not offered or introduced in evidence. We cannot, therefore, ascertain what the contents were, or whether or not the time the debts originated was shown in the schedules, or whether or not any of those debts existed on March 4, 1913.

This testimony is clearly incompetent to show what indebtedness existed on March 4, 1913.

The only indebtedness shown at that date is the

debt of $5190.00 (Trans., p. 25) due Woodard & Clarke, and the indebtedness evidenced by the promissory notes known as Trustee Exhibits 1, 2, 3 and 4 shown on pages 53 to 59 inclusive of the Record and Trustee Exhibit 5 shown on page 94, amounting to $5875.00.

There is no other evidence in the record as to any indebtedness on March 4, 1913, unless the "Joint Statement" (Trans., p. 71) rendered by Martin to appellee under date of February 1, 1913, may be considered as throwing some light on the question.

As to indebtedness shown in this statement, appellee testified (Trans., p. 70-71) that an indebtedness of about seven or nine thousand dollars to the United States National Bank, included in the indebtedness shown in the statement, had been subsequently taken care of—that is taken care of subsequent to the time of the making of the statement and the date it was handed to appellee.

This indebtedness of the United States National Bank ought to be deducted from the total liabilities shown in the statement.

Total liabilities shown in the statement	$51,184.39
Deduct U. S. National Bank indebtedness paid	7,000.00
Leaving a balance of liabilities	$44,184.39

WAS MARTIN INSOLVENT ON MARCH 4, 1913?

Value of assets above disclosed	$72,232.09
Total indebtedness	44,184.39
Value of assets over liabilities	$28,047.70

The above summary of assets and liabilities is based upon the "Joint Statement" when considered in connection with other testimony in reference thereto, under the theory that the statement, although made on April 1, 1913, may be some evidence of the value of the assets and the amount of the liabilities on March 4, 1913.

If the statement is not admissible for that purpose, then there is an absolute want of any proof of the *fair valuation* of the drug and post-card stock and fixtures and outstanding accounts on March 4, 1913, and an absolute want of any proof showing any indebtedness existing on March 4, 1913, except the debts due Woodard & Clarke in the sum of $5190.00 and the debts evidenced by the Trustee Exhibits, amounting to $5875.00; and we would summarize the assets and liabilities as follows:

Total value of assets disclosed by Record	$15,875.00
Total indebtedness	11,065.00
Excess of assets over liabilities	$ 4,810.00

The latter summary does not take into consideration any value which may be placed upon the store and post-card stock and fixtures and outstanding accounts.

The mere fact that Martin filed his voluntary petition to be adjudged a bankrupt is not of itself sufficient to establish the fact that he was insolvent on the date the petition was filed, much less at an earlier date. This is well illustrated in the case of In re Chappell (D. C. Va.) 7 Am. B. R. 608, 113 Fed. 545, at page 547, where the following language is used:

> "Any person owing debts, as defined in Section 1 (11) may file a voluntary petition. The present act does not in express terms require that the person shall be insolvent, or unable to pay all his debts in full, as did the Act of 1867; and there seems to be no reason why, if a solvent person cares to have his property distributed among his creditors in bankruptcy, he should not be allowed to do so. It will not be necessary to allege insolvency in the petition, nor to prove it, to procure an adjudication."

The above language was quoted by the Court from Coll. on Bankr. (3rd Ed.), page 46. The Court then continues:

> "If this careful text writer is correct, and he appears to be, in his statement that a solvent person may be adjudged a voluntary bankrupt, the adjudication, so far from creating, as contended by the trustee, a presumption that the bankrupt was insolvent during the period of four months before the filing of his petition, does not even show that he was insolvent at the date of the filing of the petition. It is

> true that the bankrupt in his petition alleged that he owed debts which he was unable to pay in full; but as Mr. Collier says, this was an allegation neither necessary to be made nor necessary to be proved. Let us, however, for arguments sake, assume that the adjudication established the fact of insolvency on the 8th day of November—the date of the filing of the bankrupt's petition and of the adjudication. This fact alone, whilst consistent with, did not show, insolvency at a previous date."

Appellant's counsel in their brief in the "Statement of Fact" on pages 1 and 2, make the assertion that "on the 4th day of March, 1913, Martin was heavily involved and utterly insolvent"; this utterance, as we have seen, is not based on the facts disclosed by this record. If that was the fact, it seems to us appellant had every opportunity to establish it. All the books, papers and documents of the bankrupt were in his possession, the claims proven in bankruptcy, the schedules of both assets and liabilities, were in his possession, and the bankrupt, himself, was on the witness stand; yet, in the face of all these facts, and in the face of the fact that Mr. Nelson, one of appellant's counsel, on page 18 of the Transcript, said: "It is up to me to show insolvency at that time"; there is not one word in the record which even tends to show that the store and post-card stock, fixtures and outstanding accounts, the home and the Washington County property was all the assets that Martin owned on or prior to March 4, 1913, or what the fair valuation of

the property on that date was, or what the liabilities were, if any, on that date, so that the difference between the aggregate of the liabilities and the aggregate of the assets could be ascertained and thus Martin's solvency or insolvency determined.

DID APPELLEE HAVE REASONABLE CAUSE TO BELIEVE THE PAYMENT OF THE MONEY TO HIM ON MARCH 4, 1913, WOULD RESULT IN A PREFERENCE?

If Martin was not insolvent on March 4, 1913, when he paid appellee the money, then, of course, a preference, as defined by Section 60-a, would not result, and therefore appellee *could not have reasonable cause* to believe that the payment would effect a preference.

Should this Court, however, find from the evidence that Martin was insolvent on that date, and that a preference was given, then, the question as to whether or not appellee did have reasonable cause to believe a preference would result becomes material.

In this light we will consider the question of *reasonable cause to believe.*

The witnesses are few in number, and their testimony short. Trustee Healy testified that he did not know appellee (Trans., p. 26) and that he never had any conversation with appellee (Trans., p. 30).

Not a word of the Trustee's testimony tends in any manner to connect appellee with knowledge of any kind in relation to Martin's condition finan-

cially or otherwise on March 4, 1913, or at any other time, or with notice of anything which ought to lead appellee to investigate.

Alex Sweek's testimony does not touch the question. Mr. Martin, the bankrupt, was not even asked about any fact which might tend to shed light on the question.

This leaves only the testimony of Douty and appellee to be considered.

Douty's testimony is silent as tending in any manner to elucidate whether or not appellee was possessed of any information regarding Martin's financial condition, except as to the pendency of a certain damage suit, upon which a decision was shortly expected adverse to Martin (Trans., p. 33).

Whether or not such a damage suit was pending in the courts may be somewhat uncertain of ascertainment from the Record, but Martin says (Trans., p. 63): "I had this—if you mean this damage suit"; but nowhere else is it referred to, nor does it appear what disposition, if any, was made of it, if it was in fact pending at that time.

Appellee testified (Trans., p. 89) that this statement by him to Douty had no connection whatever with the sale of the Washington County property to Douty except to "puff the land" and this fact is undoubtedly made clear from the whole testimony of Douty and appellee, for appellee, at that time was in possession of the "Joint Statement" (Defense Exhibit B), knew the facts therein disclosed and had talked with Martin about it—what assets were

not in the joint statement and what debts shown therein had been paid. Appellee, therefore, knew at that time that Martin's assets, as disclosed by the statement and his subsequent investigation in verification thereof, amounted to $72,232.09, and that his total liabilities were $44,184.39. Although, the statement, itself, clearly showing Martin's solvency, no notice was thereby imparted requiring further investigation on appellee's part; appellee, nevertheless, did investigate by checking over the statement with Martin (Trans., p. 84); and found by Martin's statements that no real estate whatever—either the Washington County property or Martin's home—was included in the statement as an asset, and that about seven or nine thousand dollars included in the statement as liabilities had been paid subsequently, thus increasing the assets by about $15,000 or $16,000, and reducing the liabilities by about $7000.00 or $9000.00, thereby ascertaining that instead of Martin's surplus as shown in the statement being only $6169.83, it was in fact from $22,000.00 to $25,000.00 greater.

Appellee was in possession of these facts when the National Bank Examiner, in February, 1913 (Trans., 91-92), requested his bank to liquidate the Martin note (Trustee's Exhibit 4) and confine its loans to its own territory. Appellee up to that time never made any demand that those notes be paid (Trans., p. 91), apparently, at least, being satisfied with the loans and the regular and frequent interest payments as disclosed by the endorsements on the

notes themselves (Trustee's Exhibits 1, 2, 3, 4 and 5).

We anticipate, although not bankers, that every bank makes some effort to comply with the lawful demands of the National Bank Examiner, and what would be more natural than for appellee, who was the president of the Hillsboro National Bank, to request or demand of Martin the liquidation at least of the bank note and the note due him individually, for in order to comply with the real spirit and intention of the bank examiner's order or request, the president of the bank ought to, himself, confine his own loans within the local territory, or else the bank itself might thereby be placed in a false position with the examiner. In this connection it must be remembered that appellee was the payee named in all of the notes, except the one given direct to the bank.

Appellee's business career had been confined very largely to the mercantile business and his banking experience was limited to recent years. It is very probable, therefore, that he attached a great deal of importance to the bank examiner's request, and felt that no attempt should be made to evade or surmount the order, and therefore concluded, as all of those notes were either made to the bank or to himself (he being the president of the bank), he should call them in, and therefore did do so.

The record is extremely vague as to the exact time appellee first demanded payment of the notes, but in the natural course of events, we may very

properly assume that it was some time in February, 1913, and subsequent to the bank examiner's request (Trans., p. 91). The natural course would have been for appellee to request payment of the notes by Martin. He probably did this and it is quite probable, from subsequent events, that Martin told him he could not liquidate at that time. Although the Record fails to disclose, we may likewise naturally conclude that Martin told appellee then that if he could find a buyer for the Washington County land, he would liquidate the notes, for appellee says, "My actual reason for making the sale was to pay myself." (Trans., p. 90); and on page 91 of Transcript further says, "When I came to make collection is when I asked for the money; when this land business came up * * *"

Along in the latter part of February, appellee told Douty that he had a good investment; knew where there was a good investment in Washington County up near Beaverton, and wanted to know if Douty knew of anybody that wanted to buy acreage. Douty asked appellee some questions about it and appellee told him about the acreage that was there, and appellee said, "Well, it could be bought for $150.00 an acre," and thought it was a good buy at that price. Douty then told appellee he might take it himself if it was a good buy (Trans., p. 31-32). Douty did finally purchase the property at $150.00 an acre—46.57 acres, and paid Martin by certified bank check $5875.00, after deducting from the total amount of the purchase price, the amount of a

mortgage against the place and accrued interest and delinquent taxes (Trans., p. 41).

Martin then paid the money over to appellee in liquidation of the notes.

The sale seems to have been consummated in the usual course. Appellee told Douty of the land and the fact that he thought it was a good investment some time the latter part of February. Douty took his time to investigate and arrived at the conclusion that it was a good investment; some three or four days later, appellee called Douty up over the telephone and asked him if he had been out to see the land, and Douty told him he had and would take it if the title was all right, and further told appellee to have everything prepared for the closing of the deal and to let him know when he was ready. Douty was satisfied when the deal was closed, and the evidence as to whether or not Douty hired his own lawyer to pass on the abstract or accepted as final a written opinion of Attorney Bagley, who was appellee's attorney, can have no bearing on the question of "reasonable cause to believe," unless a claim, at least, was made by appellant that appellee and Douty were in collusion, and no such claim is made, nor does the record disclose any basis for such a claim.

Douty purchased the land in good faith through the efforts of appellee who was conscientiously endeavoring to secure the liquidation of the indebtedness so as to comply with the request of the National Bank Examiner.

We cannot bring our minds to the conclusion that this sale was a "hurry up" sale, and that it was "hurriedly" consummated by appellee in the full knowledge and belief (as appellant's counsel seem to think) that Martin was upon the brink of ruin, and was insolvent and a bankrupt, for the reason that the conclusion does not square with the facts.

The only facts in the possession of appellee showing Martin's financial condition were those disclosed by the "Joint Statement," Defense Exhibit B, and by Martin when appellee asked him relative to said statement.

This was not the only statement which Martin gave to his creditors, for it appears in evidence that he rendered a statement of his assets and liabilities to the Woodard-Clarke Co. (Trans., pp. 66, 67).

This statement, according to the Trustee's testimony, showed Martin's net worth to be $14,805.00; and we doubt not that the money which Martin owed the United States National Bank (which appellee says was about $7000.00 or $9000.00) was not included as a liability in that statement for the reason it had been paid. If the exact amount paid the U. S. Bank was disclosed and added to the "surplus" shown in Defense Exhibit B of $6169.83, the amount thereof would, in all probability, equal the "net worth" shown in Woodard-Clarke statement, thus corroborating the authenticity of appellee's understanding.

ANSWERING APPELLANT'S ARGUMENT.

Appellant's counsel, in their brief, page 6, in stating the four elements necessary to constitute a voidable preference, say:

> "Fourth, there must have existed at the time of the transfer reasonable cause for the creditor to believe that it would result in a preference."

There is a wide difference between the "existence of a state of facts" which if known to the creditor would produce reasonable cause to believe, and "the creditors knowledge of facts" which would produce reasonable cause to believe.

The language of the Act, Section 60-b, is:

> "And the person receiving it, * * * shall then have reasonable cause to believe that the * * * transfer would effect a preference."

The creditor must have knowledge of some fact that would put him, as an ordinary prudent person, upon notice, but this fact must be brought home to him, and the mere existence of the fact, if not known to him, would not be sufficient.

Counsel say (Appellant's Brief, p. 7) the first, second and third elements of a preference are not disputed. We do seriously dispute that Martin was insolvent on March 4, 1913, or that the effect of the payment made to appellee was to create a preference, and think we have fully shown the want of

any competent testimony to establish that Martin was insolvent at that time.

The whole theory of appellant's brief seems to be based upon the "existence of a state of facts" and makes no pretense at showing that appellee had knowledge of the existence of those facts.

Appellee knew nothing of any creditors' meeting—in fact, the meeting of creditors was held just a short time before Martin filed his petition in bankruptcy (Trans., p. 18) and undoubtedly after March 4, 1913.

If Sweek knew anything about the alleged creditors' meeting, he never disclosed any fact in relation thereto to appellee, for appellee testified (Trans., p. 90) he had no business with Sweek whatever. Sweek was on the witness stand as appellant's witness and was asked nothing in relation to that subject.

Counsel lay considerable stress on some agreement whereby appellee was to postpone the payment of his debts until some of the other creditors were paid (Trans., p. 45-80) (Appellant's Brief, p. 13), but the testimony shows that whatever that agreement or understanding was, it was made along in 1911, shortly after some losses had been made by Martin at the Seattle fair, and that appellee was to wait for one year. The year had expired long before the present transaction, and Martin was continuing to do business. Surely some slight "flurry" among some of Martin's creditors two years prior could not have the effect of charging appellee with

notice of insolvency on March 4, 1913, in the face of appellee's knowledge acquired from the "Joint Statement" and Martin's disclosure with relation thereto?

It seems to us that the lower court "hit the nail right square on the head" when it said, page 77 of the Transcript, referring to the "Joint Statement":

> "He didn't loan money on this statement. This statement is only important as to whether he had reason to believe this man was bankrupt at the time the statement was received.
>
> "Now, then you get that kind of a statement from a going concern, and nothing else, and no other knowledge of his business, then the question is whether a man wouldn't assume that Martin was a bankrupt."

And again on page 78 of the Transcript, the Court said:

> "Whether he would think the firm was bankrupt or not, insolvent. If a man knew nothing at all of another's business and got that kind of a statement, showing a balance of seven or eight thousand dollars, and it was a going concern and doing business, without any information or indication that it was insolvent or unable to pay its debts, he would naturally suppose it was a solvent concern, wouldn't he?"

That is the natural conclusion to be drawn from the statement; then when Martin told appellee that his real estate was not included as an asset and

that seven or nine thousand dollars of his debts had been paid, how much more natural would be the conclusion that Martin was solvent!

Respectfully submitted,

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H. T. BAGLEY,
Attorneys for Appellee.

INDEX